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IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

NO. 341

D. B. HEINER, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania,
Petitioner,

v.

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, Co-Executors of the Last Will and Testament of Philander C. Knox.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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Brief in Opposition to Petition for Writ of Certiorari.

There is involved in this case the correct interpretation of section 214 (a) (5) of the Revenue Act of 1918, c. 18, 40 Stat. L. 1057-1066, which reads—

> SEC. 214 (a). That in computing net income there shall be allowed as deductions * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

The facts are fairly stated in the petitioner's statement, pages 2 and 3.

The orginal interpretation of the statute by the Bureau of Internal Revenue, in effect at the time when Senator Knox sold his property, reads as follows:

> ART. 141. Losses. * * *. A loss in the sale of an individual's residence is not deductible.
> *Reg.* 45, *promulgated Apr.* 17, 1919.

This interpretation is clear, definite, certain and capable of being uniformly administered.

Senator Knox sold the property with respect to which this controversy arises, in the year 1920. On January 28, 1921, the Bureau of Internal Revenue changed its interpretation of the law and promulgated the following official regulation—

> ART. 141. Losses.—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

The view point of the Bureau of Internal Revenue is further amplified by an official publication which, among other things, reads as follows—

> If, on the other hand, the property is occupied by the purchaser as his home during the whole or a great portion of the period of his ownership, a strong presumption is raised that the property was purchased for his personal use as a residence; that the transaction was not "entered into for profit" within the meaning of the statute. This presumption will not be overcome by his self-serving declaration, uncorroborated, that his purpose was otherwise.
> 0-780
> 1 *Cumulative Bulletin,* 117.

First, it will be observed in the amended interpretation of the Bureau that the profit must be "pecuniary." The statute does not say so, and this certainly seems to be

an attempt to extend the meaning of the act by implication,—contrary to the rule of this court laid down in *Gould v. Gould,* 245 U. S. 151.

If Mr. and Mrs. John Newlewed, living in a rented apartment, conclude they can save money by buying a home of their own on the installment plan, how can it be said that that is not a transaction for profit. Or, John Smith, living in Baltimore, in a house which cost him $10,000.00, takes employment in Washington, and finds himself obliged to spend a $1.50 a day for transportation, besides the waste of time in getting back and forth to his work; he therefore, trades his residence in Baltimore, at an estimated sacrifice of $1,000.00, for a residence in Washington. He figures that, although he has lost a thousand dollars in the trade, he has more than made up for it by the saving in transportation cost and the saving in time. Obviously, this is a transaction for profit, yet the Bureau of Internal Revenue says not. As a practical proposition, "profit" means net profit and arises just as much from cutting down expenses as it does from increasing gross income.

Second, by the amended interpretation of the Bureau the "pecuniary profit" must be contemplated to arise from a subsequent sale of the property. Here again is an interpretation entirely by implication. It means that if a man were to buy a house with the purpose and intent of deriving an income from the rental of the property, he would not be engaged in a transaction for profit. The Bureau now says it is not sufficient that the profit shall come from the rental of the property, notwithstanding the fact that the taxpayer never occupied the property as a residence, and bought it solely for the purpose of deriving an income from such rental. To say that a man is not engaged in a transaction for profit when he buys a residence property for the purpose of obtaining as income the rental thereof,

is simply absurd. What his intent may be after he gets through renting the property is wholly immaterial. Very likely, he may not have a fixed intent with respect to the disposal of the property at the time he buys it. The possibility of a satisfactory sale would be in his mind perhaps, or he might have it in mind to leave the property to his wife and children.

Thirdly, the Bureau says, (quoted *supra*), the taxpayer cannot prove his intent by his self-serving declaration, uncorroborated, that his purpose was otherwise (than a transaction not for profit). If the intent of the taxpayer has to be proven as of the year 1888, as the Bureau here contends, and the taxpayer is dead, how is the intent to be proven? How can anyone testify to what was in Senator Knox's mind in 1888? We all know that he was a far-sighted, thrifty man, and that he must have taken into consideration the possibility of the eventual sale of his property on Ellsworth Avenue when he bought the land and built his residence on it in the year 1888. The Bureau's interpretation of the meaning of the statute results in absurdities. Samuel Smart knows the interpretation and regulations of the Bureau, and when he builds his residence he puts a "For Sale" sign on it for a month or two, and has a photograph taken of the residence with the "For Sale" sign on it. As a further precaution, he goes to his friendly real estate broker and lists the property for sale. Honest John Brown, being uninformed in the matter, builds his residence right alongside of Samuel Smart and, although his intent and purpose is exactly the same, he fails to put up a "For Sale" sign and doesn't list the property with his real estate broker. The result is that Smart is able to meet the Bureau's test of "intent," while poor Brown will be held to have engaged in a transaction not for profit.

The next question that arises under the Bureau's pro-

posed interpretation is what must a man do to terminate a transaction "not for profit." If instead of renting his former residence in the year 1901, with some few alterations in the structure of the building, the Senator had transformed the building into an apartment hotel, would he still be engaged in a transaction not for profit? Or if he had built an office building upon the property, what then would the status have been? The Bureau of Internal Revenue apparently concedes that the disposal of an estate in fee simple will terminate a transaction "not for profit." What then will be the effect of the disposal of an estate for 99 years or the disposal of a life estate, or an estate for a lesser period of time? In this case, the Senator disposed of an estate for ten years by a lease to W. E. Corey and followed that with other leasings. If that is not sufficient to terminate a transaction "not for profit," would a lease for thirty years have done it? Where is the line of distinction?

Brief Discussion of Petitioner's Argument.

On page 2, the petitioner points out that there is no evidence in this case of the value of the property as of the date when it was leased in the year 1901. The petitioner apparently considers that this is important because he again reiterates the same statement on page 7. But in interpreting the statute, this court has said in *McCaughn v. Ludington,* 268 U. S. 106, that the loss resulting from the sale of property is the difference between the selling price and the cost or March 1, 1913 value, whichever is lower. It is admitted that the cost was $172,000.00 and the March 1, 1913 fair value was $120,000.00. How can the value in the year 1901 have any possible bearing on the case? Incidentally, it may be pointed out that if we could utilize the value as of 1901, it would be to our advantage.

On page 7 the petitioner asserts that the transaction which was ended by the sale must have begun by the purchase of the same property. If a man buys a grocery store and at the end of ten years retires from business, and rents the store to his son or someone else, is he still "entered into" the grocery business? If the law provided for a special exemption to any man who had entered the ministry, would that mean that it included any man who had ever entered the ministry at any time, regardless of the fact that he might be engaged in the bootlegging business as of the date when the taxing revenue act was enacted? At this point it may be stated that Senator Knox concluded that it was a status of the property as of the date when the Revenue Act was passed, which was determinative of whether it represented a transaction "for profit" or not for profit.

On page 8 of petitioner's brief it is asserted—

"The taxpayer sold the residence, not the lease, hence it follows that the leasing transaction was not ended

by the sale nor was it the transaction out of which the loss occurred."

How could a lessor sell a lease on his own property? What happened was that the taxpayer first disposed of an estate for years through a lease and followed it with other leases. He then disposed of an estate in fee simple. Moreover, it can well be said that the loss did arise from the lease. If the Senator had sold in 1901 when he abandoned or relinquished the property as his residence, there might not have been any loss, or at least, a loss in a much lesser amount. From the time the property was leased for rental purposes, it decreased in value steadily. Therefore, it can be said with full justification that it was the leasing of the property that was the proximate cause of the loss. The sale of the fee simple simply brought the loss into being—into reality.

The point is, however, not what was the proximate cause of the loss, but what kind of a transaction was the taxpayer entered into or engaged in when he suffered the loss. The purpose of this particular section of the revenue act was to prevent men of great wealth from escaping income tax by employing as deductions the losses which they suffered by operating pleasure yachts, racing stables, private golf courses, model dairy farms and such other fads and fancies, which are to them not transactions for profit. But Congress said that if you are entered into or engaged in something which produces income, which produces profit, and you are required to include such profit in your income tax return, as was the case with Senator Knox, then if you suffer a loss as a result of being entered into such a profit producing or income producing transaction, you may employ such loss as a deduction in your income tax return. Anything less than that would be injustice. How can it be said that a man is not entered into a transaction for profit when he does get profit by

way of rental and, moreover, is required to list such profit in his income tax return and pay income tax upon it? To first require a taxpayer to pay tax upon the profit which he derives from a transaction and then, when he puts the transaction at an end, to say that he has not been engaged in a transaction for profit and may not employ the loss which he suffers thereby, would be utterly unfair and is not lightly to be attributed to Congress.

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> "The regulations of the Treasury Department have consistently interpreted the law as contended for by the petitioner in this case."

The original interpretation of the Department in Article 141, Regulations 45, and the subsequent interpretation as amended on January 28, 1921, have been quoted *supra*. Also compare Office Decision 138, 1 Cumulative Bulletin 124, published in 1919, and also consider what was said in Order 780, 1 Cumulative Bulletin, 117, published in 1919—

> "Few, if any, transactions are 'entered into' other than for profit of some kind * * *. If the residential property be held by the purchaser out of use or under tenancy and be subsequently sold, there would seem little room for question that the transaction was 'entered into for profit' and that the loss, if any, is a proper deduction in determining net income."

What has happened in this case is that the Bureau has altered and changed its interpretation of the statute, and is seeking to apply the change in interpretation *ex post facto*, to include Senator Knox's case.

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